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SUBJECT: South Africa: Minerals and Energy Newsletter "THE ASSAY" - Issue 2, February, 2009

This cable is not for Internet distribution.

¶1. (SBU) Introduction: The purpose of this newsletter, initiated in January 2004, is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

CORRECTION Re Zambian Mining Tax

¶2. (SBU) In the last issue of The Assay, Issue 1, January 2009, the article "Zambia Abolishes Windfall Tax" stated that mining taxes accounted for 63% of government revenues. This was a regrettable over-statement, based on an inaccurate press report, as the actual contribution from mining was less than 6% in 2008, split fairly evenly between normal company tax and the now-abolished windfall tax. These figures were obtained from the Budget Speech in the Zambian Parliament and confirmed by colleagues at the U.S. and Norwegian Embassies in Lusaka. We apologize for this error.

HOT NEWS

SA Minerals Act - is it Expropriation?

¶3. (SBU) The SAG could face claims worth billions of rands after a court ruling in favor of a farmers' representative body, Agri-SA, which had coal rights taken by the Department of Minerals and Energy (DME) under the Mineral and Petroleum Resources Development Act (MPRDA) of 2002. Deprivation of old-order mineral rights could

constitute expropriation, a Pretoria High Court has found. Judge Willie Hartzenberg on March 6 ruled in favor of the arguments of Agri-SA, which claimed amounts of $75, 000 and $60,000 from the Minister of Minerals and Energy for the expropriation of their old-order mineral rights. The Minister argued that the MPRDA did not constitute an expropriation and that the Act makes provision for compensation, provided the claimant can prove their property was expropriated in terms of any provision of this Act. This was the first court case to challenge the legality of the MPRDA. Most companies have preferred not to lose favor with the DME by "muddying the waters". This ruling opens the door for other claimants to pursue compensation for expropriation of mineral rights.
¶4. (SBU) The enactment of South Africa's controversial MPRDA was bound to be challenged in court. The Act, as implemented in 2004, vests all mineral rights in the state. Further, a time period was set in which any mineral properties not worked would revert to the Qset in which any mineral properties not worked would revert to the state on the basis of "use it or lose it". Privately-held mineral rights (termed old-order rights) have to be converted to new-order prospecting and mining rights. This is not a simple rubber stamp conversion of old-order to new-order rights as was originally envisaged by holders of mineral rights, but applicants are effectively required to meet a host of obligations to have their rights converted. The Act was designed to transform the racial makeup of the sector and bring more previously disadvantaged South Africans into formal mine ownership and operations. Law firm Webber Wentzel claims that the judgement is a major victory for holders of old-order rights, but Bell Dewar (another law firm) has cautioned against too optimistic a view as compensation will be determined on a strictly factual approach having regard to the circumstances of each case.

Department of Minerals and Energy to Split

¶5. (SBU) South Africa's Minister of Minerals and Energy Buyelwa Sonjica expects her department to be split into two separate ministries if the ruling African National Congress wins the April 22 election. Sonjica said both energy and minerals were vital to the country's economy and having two separate ministries would allow more time and energy to be devoted to each. Mining experts expect the new Energy Ministry to be responsible for implementing a clear energy strategy, while the Mines Ministry would have more scope to tackle issues still unresolved. Such issues would include ensuring a genuine and broad-based transfer of more control of the mining industry to black management and ownership.

Cape Town African Mining Indaba

¶6. (SBU) Review: A cloud of gloom due to the steep downturn in commodity prices pervaded the 14th African Mining Indaba, which took place in Cape Town February 9-12. This contrasted starkly with last year's celebration of the commodity boom. Last year's concern about regional power shortages was all but forgotten, but regulatory uncertainty remained a significant issue for South Africa and the region. Although investment in and credit for mining are scarce on the continent, observers saw signs of some recovery in China, whose demand has been the key driver for mining investment.

¶7. (SBU) The Indaba is one of the world's largest mining investment conventions, attended by ambassadors, ministers and company CEOs from all parts of the world. This year's Indaba consensus was that Chinese interest in resource deals in Africa will be sustained, despite its economic slow-down. Attendance at the Indaba was down one-fifth from the record attendance last year (from 5000 to 4000). Conference Director Tim Wood told delegates that companies represented at the Indaba last year had a total market value of $1.3 trillion, but this year their value had fallen to $560 billion. Keynote speakers detailed the extent of weak global growth, particularly in the U.S. and Europe. The global slowdown had reduced demand for basic commodities, with the exceptions of coal

and gold, which still draws investors seeking safe havens in turbulent times. Some speakers pointed to signs of a turn-around, particularly in China, and observed that the mining industry had overcome cyclical downturns many times before.

¶8. (SBU) Minister's Presentation: Energy Minister Buyelwa Sonjica offered help to the South African mining industry in her opening address at the Indaba. She stressed that her Department aimed to provide an enabling environment for industry to overcome the global economic slowdown, which she characterized as a "still unfolding process". Sonjica said South Africa had to manage the current
Qprocess". Sonjica said South Africa had to manage the current
slowdown and be prepared for the next commodity boom. The Minister cited government's huge infrastructure spending and the Department of Minerals and Energy (DME) task force that is considering measures to reduce job losses, as examples of government assistance. Sonjica called on industry to use all means possible to avoid retrenchments and to engage with labor and government to look for innovative alternatives. She said she was committed to reviewing the Mining Charter to assure that efforts to transform the industry were making progress. She admitted that Broad-Based Black Economic Empowerment provisions did not always yield real broad-based transformation (that is, reaching beyond the usual BEE players.) Sonjica warned mining companies that they must submit applications for conversions of mining licenses under the Minerals and Petroleum Resource Development Act by April 30. She emphasized government's commitment to improving mine safety and securing greater downstream minerals beneficiation in South Africa. Finally, Sonjica said South Africa had postponed - but not abandoned - its plans to build new nuclear power plants.

¶9. (SBU) Mining Woes: The fall in commodity demand has raised the specter of job losses and unemployment in mining. Estimates of the number of potential job losses in the South African industry were as high as 30-40,000 (Note: The industry created some 60,000 jobs in the industry during the boom years, according to the Chief Economist of the Chamber of Mines Roger Baxter. End Note.) Mining consultancy Behre Dolbear showed a recent ranking of the investment climate for 20 mining countries, which placed South Africa nineteenth, largely because of uncertainties over security of mining rights. An investment banker warned that a number of black empowerment deals required under the Mining Charter were in financial trouble after deterioration in company earnings and share prices. (Note: Most BEE deals rely on dividend streams to pay interest on loans used to buy shares in companies. End Note.) The Minister of Finance Trevor Manuel provided a life-line of sorts to struggling mining companies when he decided to delay by a year the implementation of mining royalties, which would have imposed an additional burden on them.

¶10. (SBU) Gold a Safe Haven in Troubled Times: Gold surged to its highest level in seven months on February 17 as global equity markets continued falling, raising the metal's appeal as a safe investment haven. Speakers at the Indaba pointed out that gold was holding its value compared to all other commodities. A weakening rand caused gold to hit an all-time high in rand terms of R9,958 per ounce, which has benefited South African company earnings and share prices. Platinum at below $1,100 per ounce is less than half of its March 2008 high of $2,300 per ounce due to its reliance on the U.S. car market, which is in the doldrums. Similarly, rough diamond prices have fallen 50-60% because of the weak U.S. luxury goods market and sales are at their lowest in decades. Quantitative Commodity Research company said the uncertainties in the economy were driving investors into gold and precious metals. Stanlib Economist Kevin Libbs said although gold's contribution to South African exports had shrunk from 50% in the early 1980s to 10-12% today, the rise in gold price would be beneficial for South Africa's current account deficit and could help gold companies avoid retrenchments.

ENERGY

Government Guarantees for Eskom

¶11. (SBU) State-owned power utility's Eskom's credit ratings have dipped dramatically since the beginning of the power crisis in January 2008. This has made it difficult and expensive for it to secure funding for its projects. The SAG has thrown Eskom a life line by approving guarantees totalling $17.6 billion over 5 years to support the Eskom capital-expansion programme. This is in addition to a $6 billion equity injection already approved. Government rights
Qto a $6 billion equity injection already approved. Government rights will be subordinate to other un-guaranteed lenders and commercial creditors. The hope is that Eskom's credit rating will improve. Government has committed to repaying the debt, if necessary, in its entirety or to continue making payments on Eskom's behalf. An annual limit has been set for borrowings in any one year based on Eskom's cash-flow requirements.

Namibia's Huge Gas Project

¶12. (SBU) Namibian power utility NamPower plans to proceed with its $1 billion Kudu gas-to-power project despite the credit crisis, according to NamPower General Manager of Power Systems Reiner Jagau. Jagau said he expected commercial agreements, which have delayed the project for a number of years, to be finalized before year-end and for first gas to be piped within three years of a final investment decision. Namibia is investing in the Kudu gas-to-power

project to help overcome power shortages affecting its key mining industry and to lessen dependence on South Africa for imported electricity. The Kudu gas project is a joint venture between Tullow Oil of Ireland and NamPower. It involves pumping natural gas from the Kudu gas field to an 800 megawatt combined cycle gas power station near Oranjemund, on the coast in southern Namibia. The field is located about 170 kilometers offshore, in about 200 meters of water, and with a well depth exceeding 4,500 meters. The project is expected to generate electricity for 22 years and be connected to both the Namibian and South African power grids. The gas will be expensive and setting a competitive price is the outstanding challenge.

South Africa's Oil and Gas Potential

¶13. (SBU) South Africa produces limited amounts of natural gas and crude oil from a number of small offshore deposits along the southern coast of the Western Cape Province. Reserves are modest and will be depleted by about 2011-2012, pending further discoveries (January 2008 estimates of gas reserves were 318 billion cubic feet). Limited hydrocarbon exploration, particularly using state-of-the-art technology, has been carried out in to date for a variety of reasons and the possibility of new discoveries exist, particularly in deep waters. Natural gas produced is used to supply state oil company PetroSA's gas-to-liquid (GTL) plant at Mossel Bay, which produces liquid fuels and chemicals. In particular, the plant produces a zero-sulfur diesel that is exported or sold to local markets for blending with higher sulfur diesels, according to PetroSA Manager Faizel Mulla. PetroSA is looking to secure other gas supplies, including imports of LNG, to maintain production at its GTL plant. South Africa's synthetic gas-to-liquids producer Sasol imports some 4.25 billion cubic feet per year of natural gas from Mozambique to feed its petrochemical plant at Sasolburg and to supplement feed to its coal-to-liquid (CTL) facility at Secunda.

¶14. (SBU) U.S. firm Forest Oil is developing the Ibhubesi gas field, which lies some 70-80 kilometers off the Western Cape coast, 300 kilometers north of Cape Town. The field is estimated to contain reserves of about one trillion cubic feet of gas, based on an initial four exploration well drilling program. Five additional wells were subsequently drilled, partially funded by South African partner PetroSA, but these yielded disappointing results and did not

add to the reserve base. The field is not in production as majority shareholder and operator Forest Oil has been waiting for a production license and finalization of the fiscal and regulatory regime from the local authority for a number of years. Forest recently posted Director John Langhus to Cape Town to procure the licenses, negotiate markets for the gas onshore, and generate a Qlicenses, negotiate markets for the gas onshore, and generate a return on the $100 million total investment in the project ($57 million by Forest). Prime candidates to take Ibhubesi gas are state power utility Eskom and west coast industrial companies at Saldanha Bay. (Note. It was hoped that Ibhubesi might have sufficient gas to feed PetroSA's GTL plant, but it appears that the reserve is too small to justify the costs of a 400-600 kilometer pipeline to the plant at Mossel Bay. End Note.)

BHP-Billiton Exploration May be the Answer

¶15. (SBU) Diversified miner BHP-Billiton's aspiration to drill a $50-$70 million exploration oil well in deep water (2,000 meters) off South Africa's west coast has been stymied by the lack of fiscal and regulatory certainty caused by changes to the new minerals legislation. The company and the South African government are progressing in their discussions on the fiscal framework under which drilling for oil offshore could proceed, according to new BHP Billiton Southern Africa Chairperson Dr Xolani Mkhwanazi. BHP has two oil exploration concessions, covering an area of 21,630 square kilometers, in water depths ranging from 300-2,500 meters, and

situated 175 kilometers northwest of Cape Town. The company is understood to have spent $20-$30 million on its west coast surveys and studies so far and has been negotiating with various branches of the South African government for some time on exploration concessions. Mkhwanazi said the proposed project would be mutually beneficial for both South Africa and BHP and that the company was seeking long-term stability for itself beyond the exploration phase. He said BHP needed a long-term financial regime that is consistent over time and government needs BHP to provide a long-term guarantee of investment.

GE Upgrade Sasol Steam Turbines

¶16. (SBU) U.S. company GE Energy and oil-from-coal company Sasol have entered into a multi-million-dollar agreement to upgrade the reliability and efficiency of Sasol's steam turbines at their Secunda synfuels facility. The upgrade using modern materials, design, and components will significantly reduce the probability of unplanned outages, result in significant turbine life extension, and reduced future maintenance expense, according to GE Energy Africa Region Executive Mark Digby. The upgrade will improve the overall efficiency of Sasol's steam use and, thereby, increase its on-site power-generation capacity and reduce electricity demand on Eskom.

PBMR Re-Engineers Itself

¶17. (SBU) South Africa's home-grown nuclear power company, the Pebble Bed Modular Reactor (PBMR) company faces budget constraints and is in the process of redefining its near-term market strategy. This was prompted by its major shareholder's (state-owned Eskom) difficulty obtaining funding due to its risk downgrading, coupled with the global financial crisis, and the growing demand for process-heat and hydrogen generation. Modification of the design planned for the demonstration power plant at Koeberg near Cape Town is under consideration to enable it to service potential customers such as Canadian synthetic oil producers and petrochemical company Sasol. Both need large quantities of high-temperature steam to extract bitumen from oil sands and to convert coal to liquid fuels and chemicals, respectively. A potential application, vital to water-constrained South Africa, is the use of PBMR's waste heat for desalination. According to PBMR CEO Jaco Kriek, certain contracts

are likely to be put on hold to prevent unnecessary spending, but he emphasised that no contracts had been cancelled.

MINING

Beer Better than Anglo

¶18. (SBU) Diversified South Africa-rooted miner Anglo American has dropped to third place on the South African stock market behind beer-brewer giant SABMiller. SABMiller is valued at R234 billion verses Anglo's R210 billion. Anglo's shares took a pounding on the
Qverses Anglo's R210 billion. Anglo's shares took a pounding on the market when it decided to suspend dividend payments indefinitely to conserve cash, for the first time since the start of World War II. Additionally, operating results were worse than anticipated due to the fall in commodity prices in the second half of 2008 and its share price has fallen by nearly 70% since September 2008. These factors also caused CEO Cynthia Carroll to announce the company's intention to shed some 19,000 jobs -- 10,000 from Anglo Platinum in which Anglo holds an 80% interest -- and the rest across geographies and business units. Carroll blamed the company's poor performance on the world economic crisis, falling commodity prices, the unprecedented level of uncertainty, and the poor near-term outlook for commodities. One ray of light was the increased demand for

iron-ore from China in the first months of 2009. Iron ore production at Kumba's Sishen Iron Ore mine, Anglo's 65%-owned subsidiary, increased 13% to 36.7 million tons per annum.

Ignore Africa at Your Peril

¶19. (SBU) It doesn't make sense for a mining company to be serious about growth, without looking at possibilities in Africa. So said AngloGold Ashanti CEO Mark Cutifani at a BMO Capital Markets mining conference in Florida. He said he is becoming increasingly optimistic about Africa, which hosts an estimated 30% of the world's mineral resources. Besides its South African assets, Johannesburg-based AngloGold has mines in Ghana, Guinea, Mali, Namibia and Tanzania, as well as exploration property in the north-east of the Democratic Republic of Congo. Despite ongoing uncertainty because of the mining contract review under way in the DRC, the firm plans to hold onto its assets there. Cutifani said AngloGold had "a great piece of ground" in the DRC and was still in talks with the government about potential changes to its mineral lease agreements, but was optimistic about a positive outcome. He said the country needed more time, perseverance, and support from significant players in the region and AngloGold is watching the progress made by Phoenix-based Freeport-McMoRan at its Tenke Fungurume copper/cobalt project with great interest.

Asia - Key to South Africa's Mineral Exports

¶20. (SBU) South Africa's growth outlook is increasingly dependent on trade with Asia. Nearly 30% of its exports go to Asia, according to the Standard Bank and these fell 10.5% year on year in December. Total exports to the region for the first 11 months of 2008 were worth about $18 billion, with minerals accounting for 73% of that figure. Base metals contributed $4.5 billion, coal $4.4 billion, and precious stones and metals $4.2 billion, according to the latest available SA Revenue Service figures. The fall in Asian demand is due to the region's own export performance, according to UK-based think-tank Chatham House, where declines of some 30%-40% since November have been recorded by countries such as South Korea, Taiwan, and Japan. Emerging Asia was still expected to grow at 2%-3% in 2009, Chatham House said, but their forecast was dependent on a relatively robust growth for China and, to some extent, India. Should these fail, Asia's average growth rate may be close to zero.

Given the size of Asia and its imports, such a decline would create major negative impacts on South Africa's commodity exports.

Power Shifts in African Mining

¶21. (SBU) Governments in both the developed and developing countries tend to become dissatisfied when mining companies earn most of the additional (windfall) revenues from inflated commodity prices during Qadditional (windfall) revenues from inflated commodity prices during boom times. This may give rise to "resource nationalism", which can take the form of government intervention and renegotiation of fiscal, tax, royalty, and ownership agreements aimed at increasing government revenues or even total nationalization of mineral assets. These actions may be taken, with or without consultation with affected companies. In most cases, governments have the upper hand as sunk costs and immovable assets prevent companies from taking significant retaliatory measures. Cases in point include South Africa's new mineral legislation, Zambia's proposed windfall taxes, and the DRC's review of mineral leases and mine ownership shares. However, the current global financial crisis has seen commodity prices and trade halved and the negotiation table turned somewhat in favor of mining companies.

¶22. (SBU) The balance of bargaining power between resource companies and African governments is shifting in favor of investors in the

wake of collapsed commodity prices. Control Risks company's sub-Saharan Africa analyst Christopher Melville advised companies at a briefing in Johannesburg to exercise restraint when seeking to push home this advantage, lest they run the risk of a backlash from governments once economic conditions improve and prices started to rise again. He said he expected emerging market demand, particularly from China and India, to return as their fundamental drive for economic development remained in place and would kick in again sooner rather than later. He suggested that, given the current depletion of stocks and the closing of a number of African projects, there was a good possibility that commodity shortages could re-emerge as early as 2010. He pointed to two significant deals involving Chinese companies, namely state-owned Chinalco's offer to nearly double its equity stake in Rio Tinto to 18% and Australian company Oz Minerals' agreement to sell all its outstanding shares to Chinese company Minmetals Nonferrous Metals in a deal worth about $1.7 billion.

Mintek to Footprint Diamonds

¶23. (SBU) The legitimate global diamond trade is worth some $60-$70 billion annually, but is currently being scorched by the economic crisis, which has cut demand for rough stones by more than 60%. This, in turn, has cause De Beers to close all its operations in Botswana, which provides the bulk of its rough diamonds. The global industry's debt peaked at $14-$15 billion in mid-2008, according to banks and industry groups, but credit plays a crucial role in financing the industry. The burden of this debt increases as diamond sales and revenues decline. Currently, trade is about one-tenth of usual levels. Trade in illicit diamonds, though small, has an impact on the legitimate trade, especially in times of crisis. Hence the South African Diamond and Precious Metals Regulator (SADPMR) and state-owned research parastatal Mintek have launched a project to study the possibility of determining the origin of rough diamonds. According to Mintek, the study is aimed at ascertaining whether trace element analysis can be used in combination with physical characteristics to link diamonds to their source, particularly in the case of illicitly traded stones.

¶24. (SBU) The heart of the project is a new laboratory facility in Mintek's Mineralogy Division, which is funded by the SADPMR and equipped with state-of-the-art equipment capable of analysing more than 70 elements at sub-parts-per-billion and lower levels. According to SADPMR Strategist Ashok Damarupurshad, if proven successful, diamond fingerprinting would help to reduce theft and

illegal mining and assist in preventing conflict diamonds from entering the legitimate trade. That is the objective of the Kimberley Process Certification Scheme and the reason that the SADPMR provided the initial funding to establish the laboratory at QSADPMR provided the initial funding to establish the laboratory at Mintek. The laboratory was completed in November 2008 and is the first of its kind in Africa. Mintek has also launched a project to study the origins of rough diamonds, which it says will focus on diamond sources in southern Africa, particularly alluvial diamonds, which are less easy to control than those from kimberlite (hard-rock) mining operations.

Infrastructure

Kumba Offers to Assist State Rail Services

¶25. (SBU) There is a mismatch between South Africa's rail capacity and that of mine production and port handling capacities. Iron ore and coal producers want to mine and export greater tonnages, but inadequate rail capacity, poor management, and inefficient operations have put an effective cap on export expansion. Both the coal and iron ore producers have volunteered to build new facilities

or lease and operate existing ones to assist government to implement proposed expansions, but this has been turned down. Government-owned parastatals seem ideologically opposed to private ownership or involvement in state enterprises and unions have vigorously opposed any such moves by government. Until recently, the prospect of a public-private-partnership (PPP) has not been an option available to iron-ore miner Kumba Iron Ore (KIO), 65% owned by Anglo American. However, the company started discussions with state-owned Transnet Freight Rail towards the end of 2008 on the possible creation of a PPP. The door for such an engagement with government seems to have slightly opened, according to KIO CEO Chris Griffith.
La Lime